



Testimony of
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Introduction

Chairman Stearns, Ranking Member Towns, I am Sam Gilliland, President and CEO of Travelocity.com, the nation's most popular online travel site. I want to thank you for the opportunity to testify today. This Subcommittee has shown great leadership on many critical electronic commerce and consumer protection issues, ranging from privacy to cyber-crime to restraints on digital trade. We at Travelocity share your commitment to facilitating public policy that will create an online environment that is good for business and good for consumer welfare. The focus of this hearing on the consumer implications of online, supplier-owned travel agency joint ventures is an excellent opportunity for you to begin examining, and I hope reversing, a dangerous e-commerce trend across a growing number of industries.

Travelocity (along with other independent travel retailers, business travelers, consumer groups, several small and low cost airlines, a large and growing number of Members of Congress, and other government officials) has been an outspoken critic of Orbitz, the joint venture owned by five of the nations' largest airlines. Travelocity has never argued that Orbitz should be restricted from entering the market; to the contrary, there is room for more competition in online travel. Our concern has instead been focused on certain features of the Orbitz contract which we believe unnecessarily restrict the ability of airlines to provide consumers better access to the lowest fares in the marketplace. These features are the so-called "most favored nations" (MFN) provisions and exclusivity incentives. These clauses, which provide to Orbitz long-term

contractual access to a full array of the major airlines' fares and inventory, threaten all independent travel retailers and the consumers we serve.

We hope that this hearing will help catalyze the continuing efforts of Congress, the Department of Justice, the Department of Transportation, and other government officials to find a workable solution to the Orbitz problem. We have called on them to remove these anticompetitive clauses and require Orbitz to do what all other travel retailers do everyday -- compete on the merits of their technology, customer service and marketing ability -- and not on contractual guarantees that insulate Orbitz from true competition and serve as a deterrent to airlines from offering their lowest fares to a greater number of consumers. We have also called on the DOT to update and modernize the CRS rules to address the Orbitz issues -- for the sole reason that the rules were last revised 10 years ago and therefore do not apply to airline-owned online travel retailers, but only to traditional computer reservation systems marketed to travel agents.

Mr. Chairman, this hearing before this subcommittee is critical, because it is consumers and their welfare that this debate is all about. We believe that much is at stake for consumers now, and much more profound harm is in store for them if Orbitz' plan is executed without restraint. Consumers are increasingly being denied a choice in travel agents, both online and offline, as they are being forced to go to Orbitz, through the operation of Orbitz' MFN and exclusivity provisions, for full access to the major carriers' lowest fares. Consumers are required to pay an across the board service fee on Orbitz that the major independent online sites do not currently charge, and this fee will almost certainly rise as Orbitz accounts for an ever larger share of airline ticket sales. Orbitz and the Orbitz MFN are actually catalysts for transferring the costs of distribution directly to consumers --

although it is highly unlikely that consumers will see equivalent reductions in airfares as Orbitz' service fees will undoubtedly increase. With the ascendancy of Orbitz, consumers are losing the benefits of airline competition that the independent travel web sites have until now fostered both by forcing the major carriers to compete with each other and by giving new entrant and low cost carriers – the major force for keeping airfares low -- a better opportunity to compete with the majors. Left unchecked, the operation of the anti-competitive provisions of the Orbitz agreement will inevitably lead to less consumer choice, less airline competition and higher consumer prices for air travel.

The online travel market in which Travelocity.com participates is growing at a rapid pace and, according to the research firm PhoCusWright, "is the fastest growing e-commerce category." With the rise of the Internet, independent travel retailers – both brick-and-mortar and online – are increasingly using this distribution channel to expand the richness and reach of their product and service offerings to the ultimate benefit of consumers, who benefit from the more robust airline competition the independents foster.

A key component to the continued growth and consumer gains in the Internet travel market is fair access to information from travel suppliers and, in particular, access to travel suppliers' lowest fares and corresponding inventory. It is of no benefit to companies that distribute airline tickets if they develop the best low fare search technologies but are denied access to the full range of airfare inventory. At Travelocity, while we are focused on providing the best technology and customer service, we are also focused on giving our customers -- both business and leisure -- the most comprehensive access to the lowest fares and rates available. After all, that is what consumers demand and rightly so.

You will hear from Orbitz that it offers the carriers lower distribution costs in exchange for the guaranteed contractual access to their inventory that Orbitz alone enjoys. This is simply not true. Independent retailers, like Travelocity, have repeatedly offered to meet or beat Orbitz's economics, and yet have been denied equal access to the low fare inventory Orbitz receives. On July 11, American Express stated that for the last six months or so it had offered to pay a portion or all of the airlines' distribution costs relating to certain fares and inventory only provided to Orbitz, but thus far no airlines have accepted American Express' proposal.

We strongly believe that the denial of fair and open access to travel information to independent travel agents raises substantial public policy questions that Congress, the Department of Transportation, the Department of Justice and other government officials must address.

Travelocity.com and the Online Travel Distribution Channel

Travelocity.com is an Internet commerce pioneer. Since our initial launch in March 1996, our customer base has grown to more than 34 million members. We have built this successful business and a solid brand by constantly innovating and creating new products that take advantage of Internet technologies to bring benefits to consumers and travel suppliers alike. We believe we are changing the way consumers can shop for and buy travel. Some of our web site's innovations and features include: (i) Alternate Airports – which provides alternative city fare information (often bypassing hub airports) in response to a given fare request; (ii) "Dream Maps" – which offers leisure travelers on a limited budget the ability to view "theme" vacations (i.e., beach, ski or national park packages) that

compare and select among the best fares for multiple destinations, and (iii) Best Fare Finder – a revolutionary product that shows consumers calendar-based fare offerings, so that they know precisely when advertised low fares are really offered.

While travel suppliers are understandably focused on maximizing the amount of revenue they receive with each sale of inventory, at Travelocity.com we are focused not only on giving travel suppliers an excellent, low-cost selling channel but perhaps more importantly, on providing *consumers* with what they want, which, more often than not, is the **lowest** available fare. We have invested heavily to improve the speed and functionality of our site. As noted by one airline industry analyst, “the philosophy [of independent travel web sites] is to push the price lower -- a complete reversal of the aims of an airline’s own yield management team.”¹

Travelocity.com creates a global storefront for consumers to see, experience, research and buy their travel in one place. As such, Travelocity is the “front-end” or user interface through which consumers access a vast virtual warehouse of travel information, such as supplier inventory, prices and schedules.

Just like any other travel agency in the world, Travelocity contracts with one of four computer reservation systems (CRS) for access to this supplier information. Travelocity’s agreement for these “back engine” services is with Sabre, the CRS owned by Sabre Holdings Corporation, Travelocity’s parent. CRSs are closely regulated by DOT (and also by DOT’s counterparts in Canada and the European Union). One of the bedrock principles of these rules is the requirement that the airlines that own CRS’s participate in the other CRS’s to the same extent they participate in the systems they own, so long as

¹ *Reuters Finance* (Feb. 23, 2000) at <www.biz.yahoo.com>.

the other CRS's offer the airlines commercially reasonable terms. These are rules of fair play designed to protect competition and consumers and they have stood the test of time.

Currently, the CRS rules in the United States, unlike the rules in Canada and the European Union, do not apply to the distribution of airline information directly to consumers via the Internet. The CRS rules were last amended in any significant way in 1992 (before the Internet became a major channel for e-commerce) and were scheduled to sunset in December 1997. It was over five years ago that DOT first solicited comments on how the rules should be updated to reflect the multitude of changes in the travel distribution landscape that had already occurred since the regulations were revised in 1992.

Ten years ago, all CRSs were owned and controlled by large airlines. Today, two of the four traditional CRSs, including Sabre, are free of all airline ownership. This structural change has effected substantial modifications in the fundamental incentives and business goals of those independent CRS enterprises. Further, in 1992, the Internet was in its embryonic stage as a tool for the distribution of airline products, with only a handful of airline sales made online. At present, roughly 15% of all airline tickets are sold through the Internet and the percentage is growing rapidly. If these rules are to remain in effect, these rules need to be modernized.

I understand that a draft of the rules has been completed and is under review at the Office of Management and Budget. The revised rules must sufficiently and appropriately address the most critical issues facing travel distributors today, including the ability of travel distributors to obtain access to the lowest fares of travel suppliers that own competing travel agent sites, as exemplified by the airline-owned site Orbitz

(we are not seeking to have these rules apply to data that the carriers put only on their proprietary single carrier web sites). In revising these rules, DOT must strive for fairness. It makes no sense to have rules insuring fair competition and consumer protection for the offline environment that are not applicable to the online environment. For example, core antitrust principles are not solely applicable in the offline environment, but govern all commerce. Either the rules should apply to both, or not at all. Further, even after five years of delay, it makes no sense for DOT to attempt to regulate until it receives critical inputs from the Commission Congress chartered two years ago and DOT just recently formed to study the plight of travel agents, and until the Inspector General completes the separate study on Orbitz Congress required as part of last year's Appropriations bill. These exercises are directly relevant to how the rules should be modernized, as the DOT itself has acknowledged. In short, DOT should not put the regulatory cart before the horse.

How Orbitz Operates – Though MFN and Exclusivity

Evidence of how Orbitz operates in the online travel channel may be found in its "Airline Charter Associate Agreement." Based on the most favored nations language in this agreement, airline participants may not undercut the prices they post on Orbitz, either by putting lower prices on their own web sites or by running promotions (even one day sales) with online competitors of Orbitz. The MFN specifically requires that any published fare posted on the airline's own web site or on any third party site be given immediately to Orbitz. Under the agreement, "published fares" are broadly defined and include the overwhelming majority of fares in a given airline's inventory.

In addition, the owners agreed among themselves to impose annual in-kind promotional support obligations on carriers, with one of the ways carriers could meet this obligation being to offer their lowest fares **exclusively** through Orbitz. It works this way: Each participating carrier is obligated to provide Orbitz with substantial “In-Kind Promotions,” which can run into the millions of dollars. Among other things, these obligations can be satisfied by offering “exclusive promotions or fares available only on” Orbitz or the participating airline’s own Internet travel site. Orbitz can withhold certain rebates if the carrier and Orbitz fail to develop a mutually acceptable promotional plan and/or if the carrier fails to adhere to the terms of that plan.² Moreover, Orbitz’ requirement that all participants immediately provide to Orbitz all promotions and fares that are offered using alternative distribution methods will undercut any incentive by Orbitz to innovate by developing and packaging special promotions from suppliers.

These very unusual contract provisions were the subject of much controversy in 2000 and early 2001 as the Department of Transportation and Department of Justice considered what safeguards might be required up front, before Orbitz’ launch. DOT (and DOJ) nonetheless allowed Orbitz to launch without any limitations on its ability to enforce the MFN clauses and exclusivity incentives. An analysis of that DOT decision, and an examination of the events of the months since Orbitz began operation, leads only to the conclusion that if there were ever a basis for permitting Orbitz to enforce either of these provisions, it evaporated long ago.

² The non-equity owning carriers can also apparently satisfy these requirements by providing Orbitz with “passenger database information” and “competitive purchaser names” (e.g., e-mail addresses of passengers who booked travel through another online agency).

In and of themselves, the terms of the Orbitz agreement with its participating carriers have impaired the ability of consumers to have broader access to lower airline fares. This harm to the competitive airline process has materialized with even more severe, long-term harm inevitable. In its April 13, 2001 letter to Orbitz, DOT acknowledged that “critics argue that the MFN clause undermines the ability of individual airlines to make clandestine deals with other internet travel sites – deals that they rightly contend have a pro-competitive effect on pricing... Thus, there is some potential impact on the market dynamic.”³

While “under the radar” sales by airlines on independent travel agents have slowed, the volume of immediately detectable web fares offered on Orbitz has exploded. Orbitz’s strict most favored nations requirement, which it strongly polices, ensures that price discounts are immediately detectable by all carriers at the same time every working day. To the detriment of consumers, this environment acts to discourage discounting, because there is no way for carriers to create even a temporary advantage over competitors.

In its June 27, 2002 Report to Congress, DOT recited the concerns of those smaller low-fare carriers opposed to Orbitz because, among other things, “they do not want to lose their ability to selectively engage in deals with other online agencies and distribution channels without the obligation to also give these deals to Orbitz.” Even more telling, one such carrier stated the in-kind advertising commitment was “designed to burden small low-fare carriers with higher distribution costs.”⁴

³ DOT Letter at 4.

⁴ DOT Report at 13.

Exclusivity and Web Fares

In the April 13, 2001 letter, DOT expressed its rationale for allowing Orbitz to launch with contractual incentives to provide content to Orbitz exclusively. The Department expressed strong misgivings, saying:

We have serious concerns about incentives toward exclusivity, however limited. While we are prepared to reserve judgment until we see how this provision operates in the marketplace, we will monitor these developments closely. Allowing a new entrant with no sales or market share to offer financial incentives to get exclusive access to a very limited portion of supplier inventory may be a legitimate means of overcoming entry barriers.
(emphasis added)

As predicted by many of its critics, in the months following its launch the owners of Orbitz made available to Orbitz -- and Orbitz alone -- wave after wave of web fares, often for discounts across all or much of their entire network of flights⁵. The representations made by Orbitz to induce DOT to allow it to commence operations unfettered by standard rules of fair play -- namely, that web fares would represent only "1/10th of one percent" of the fares offered⁶-- have proven to be completely false. To the contrary, our research indicates that web fares account for at least 60% of Orbitz' total airfare sales, and those fares were generally unavailable for negotiation (as American Express and others can attest) and therefore denied to other travel retailers to the ultimate detriment of consumers.

⁵ Of course, Travelocity welcomes low fares and the more the better. However, because the largest carriers in the U.S. have withheld comparable low fares from any of the tens of thousands of offline and online travel agencies that compete with the agency they jointly own -- Orbitz -- they have distorted competition in the field of airline ticket distribution and have also injured those millions of consumers and businesses who, for all sorts of valid reasons, choose to deal with travel agencies that are independent of the big carriers.

⁶ See DOT Letter at 7.

Importantly, these Orbitz web fares are not simply last-minute weekend travel fares on flights that have an unusually high number of empty seats; they are instead wide swaths of the airlines' fares on flights and available for more advanced booking. On February 26, 2002, Karl Peterson, CEO of Hotwire, a travel web site owned by four of the five Orbitz owners succinctly described the transformation of the uses of web fares by large airlines, noting:

“[N]o longer are web fares surgical. They are closer to a published fare sale than they've ever been....”

Because of this guaranteed access to low web fares on the Big Five – and not because of any technological innovation or high level of customer service -- Orbitz has become one of the top three online sellers of airline tickets.⁷

In recent months, some of the Orbitz carriers have started to provide limited access to some web fares to some independent retailers. This has not, however, solved the problems raised by the Orbitz MFN or leveled the playing field. For example, Orbitz has now confirmed publicly that it has 10 year contracts with its owners that, among other things, guarantee Orbitz access to all these web fares.

A key premise of the DOT's decision allowing Orbitz to proceed was that a “very limited portion of supplier inventory” would be made available to Orbitz on an exclusive basis. In other forums, Orbitz executives had asserted that these special web fares to which it alone would have access would not account for any significant portion of the lowest fares it offered. In a May 22, 2001 speech to the Aero Club, Jeff Katz said:

⁷ Orbitz claims that it does not have “exclusive” fares because most of these fares are also available on the individual carriers' web sites. While Orbitz engages in such semantic games, this form of self-dealing is hardly the type of robust competition a free and fair marketplace would demand.

"We estimate that about 99% of the time that Orbitz produces a lower fare, it will be *[sic]*not be because we had access to a fare others did not, but because we found a fare that everybody had access to, but not everybody could find. Or not everyone chose to display."

As any observer of Orbitz will know, this statement has not proven to be accurate. Instead, in the 13 months since Orbitz commenced operation it has offered numerous "web only" discounts that the five Orbitz owners made available on Orbitz, but denied to all of Orbitz's independent competitors, online and offline.

Smaller Carriers Have Consistently Poorer Sales In Orbitz

There is more data that should concern consumers, evidence that has ominous overtones for the future of airline competition and e-commerce. A number of concerned parties predicted in 2000 and early 2001 that Orbitz would be designed and operated in ways that would neutralize the ability of the small, discount carriers to achieve a premium share of ticket sales in the independent web sites. For example, Orbitz's refusal to allow airline advertising in the airline displays was seen by many as an attempt to deprive smaller airlines of a very useful, point-of-sale technique that touted their bargain fares. Through banner ads promoting their fare specials, smaller carriers had been able in the independent sites to overcome their lack of name recognition and to attract needed incremental business.

In short, the data show that the small discount carriers **do** attract a substantially higher share of sales in the independent sites and that in Orbitz the major airlines have succeeded in nullifying that phenomenon.

As forecasted by many, the hard sales data for the months since Orbitz's launch show that smaller and low fare carriers do much more poorly in Orbitz than in the two

largest independent web sites. These low-fare carriers achieve a percentage of total bookings that is 15% to more than 200% larger in the independent sites than in Orbitz.

Simply put, the data concerning how smaller airlines do in Orbitz are a bad omen of what the future holds for them and consumers. Moreover, they are a stark reminder of what the world was like for smaller carriers in traditional CRSs before the Civil Aeronautics Board adopted rules in 1984 to governing the operation of airline-controlled CRSs.

In response to this uneven competitive playing field, many travel retailers have responded by shifting their focus away from the sale of scheduled air, where they have long been positive forces for airline competition, to the sale of other products, such as hotels, package vacations and cruises. Lowestfares.com recently announced that it was discontinuing selling airline tickets entirely. In contrast, Orbitz's recently filed S-1 reveals that almost 90% of its 2001 revenues came from the sale of air transportation. As Orbitz becomes a larger seller of air transportation, this is not likely to be helpful for small and low-fare carriers (such as JetBlue and Southwest, neither of which participate in Orbitz), nor for the consumers who look to them to serve as a competitive spur for lower fares. As independents shift their focus away from the sale of scheduled air service, consumers lose choice as well as the competitive pressure that comes from agents who have historically provided them with tools to help them find the best deals. Orbitz, as an airline joint venture, has little incentive to provide or improve upon these tools particularly as competition from independent, non-airline owned sites diminishes.

Should Orbitz Be Permitted to Operate?

Travelocity has never asked that Orbitz be blocked from operating. Instead, we have expressed concern over the consumer harm and competitive implications of DOT not taking action while Orbitz implements a business plan predicated on exclusive access to the lowest fares of the five largest carriers in the U.S. Orbitz did not have to compete or negotiate for that access, but was simply given (and guaranteed) that access – which is not indicative of a competitive marketplace. We have urged the government to address this risk head-on, certainly allowing Orbitz to exist and engage in competition with the rest of us, but to be mindful of the “rules of the road” in any competitive marketplace and to consider the lessons learned from prior airline owned distribution ventures. This simply means removing the anticompetitive contract clauses and modernizing the CRS rules. These are surgical actions that can be taken and in no way constitute “regulating the Internet” as Orbitz has asserted.

What Should Be Done?

We believe DOT or DOJ should act now to ban the use by Orbitz of the two contract provisions that require carriers to collectively provide “most-favored nations” treatment to Orbitz with respect to fares and inventory. The agencies should also void the provisions of the Orbitz Agreement that collectively give carriers financial incentives to confer fares and other content on Orbitz on an exclusive basis. DOT’s June 27, 2002 Report to Congress raised concerns about Orbitz, but failed to reach conclusions on what should be done, deferring instead to DOJ, which continues to have open a long-standing investigation,

which has no timetable for conclusion. If the agencies fail to tackle these problems, it may be necessary for Congress to step in and come up with a solution.

Unfortunately, DOT has not addressed the “sea changes” in the industry that have occurred over the past ten years. The limited scope of the U.S. CRS rules, which apply only to computer reservations systems to the extent these systems are used by travel agents, may have made sense in 1992. However, at a time when tickets sold online directly to consumers are approaching 15% of all sales, it is nonsensical to say that stringent rules banning the withholding by airline owners of key flight data are essential elements of public policy in the case of the four traditional CRSs (two of which are no longer airline owned), but that a ticket distribution system like Orbitz that is backed by the combined strength of the five biggest airlines, gets a free pass. This is bad public policy.

In fashioning the appropriate response to the competitive harm of Orbitz, DOT should be mindful of the policy underpinnings of the rules. In 1984, the CAB found that regulation of airline owned or marketed CRSs was necessary because, it concluded, airlines that owned the electronic distribution outlets for airline tickets had both the means and the incentive to use that control to advance their fortunes as airlines. DOT found a documented halo effect in terms of sale of tickets sold through the systems that favored major carriers that owned distribution outlets at the expense of smaller carriers.

In 1992, DOT affirmed that view and also found that airlines had an inherent incentive and power to favor the distribution outlets they owned over all others. No good reason exists today to believe that these fundamental dynamics in the airline industry have changed. In the face of those facts, it is difficult to see how rules

designed to prevent abuses by even a single carrier owning a traditional CRSs offered to travel agencies are not applicable to this scenario where the five largest air suppliers form a joint venture to operate a distribution web site targeted at consumers.

DOT should promptly take the steps needed to apply with respect to Orbitz the same regulatory safeguards that it found long ago were necessary to protect competition in the case of traditional airline-owned CRSs.

Conclusion

Based on its MFN and exclusivity provisions that lead to exclusive access to web fares on the nation's five largest airlines -- fares that predominate its listings despite its earlier representations to the contrary to DOT -- Orbitz has gone from nowhere to become the one of the largest Internet travel agencies, and has achieved this position without having to compete for this favored access to fares and inventory. This is perhaps the most troubling aspect and key issue in supplier owned joint ventures -- the danger of distorting competition and creating an uneven playing field which ultimately harms consumers and competition.

Action is needed now to prevent Orbitz from continuing to benefit from its supplier-owned structure and favored access to inventory -- which it did not obtain through competition -- and protect the competitive dynamic and promise of Internet distribution to bring lower prices and more innovative technology and tools into the reach of more consumers. If the MFN provisions were ever justifiable in April 2001 because Orbitz had "few sales and no market share" and if the exclusivity incentives might have been defended as a legitimate means to "overcome entry barriers," those reasons for DOT or DOJ to stay its hand have disappeared completely.

The rise of Internet commerce has initiated a true revolution in the travel distribution industry, and holds the promise of greater efficiency and enhanced competition at all levels. As a policy matter, and as a legal matter, we do not believe suppliers should be able to engage in collective action to withhold information from independent distributors. This is an obstacle to e-commerce that this committee should strive to remove.

In this country, laws and rules exist that prevent such boycotts from occurring – and it's time to enforce them now. Consumer choice, robust airline competition, and access to low fares are at stake here; broader issues of e-commerce and consumer harm hang in the balance as the Orbitz model is replicated by other suppliers in other industries.

Thank you for the opportunity to testify and I look forward to answering your questions.